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September 1, 2017

Gerard Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Re: Comments on Stabilization Fund Closure

Dear Mr. Poliquin,

I appreciate the opportunity to comment on the NCUA's plan to close the Temporary Corporate Credit Union Stabilization Fund (TCCUSF). On behalf of Listerhill Credit Union's more than 90,000 members, we strongly support the concept of closing the Stabilization Fund as soon as possible, with a distribution back to credit unions in 2018.

We urge the NCUA to adopt the recommendation of Credit Union National Association (CUNA), that NCUA merge the TCCUSF into the Share Insurance Fund as soon as possible, preferably in 2017, and only increase the normal operating level (NOL) by 4 basis points to insulate the Share Insurance Fund from legacy asset volatility, and pay all excess equity in the Share Insurance Fund to insured credit unions as soon as possible in 2018. The CUNA proposal is clearly supported in their comment letter to NCUA dated August 31, 2017.

We feel the CUNA proposal strikes an appropriate measure of conservatism in the distribution of the excess assets garnered by America's credit unions to battle the unfortunate economic crisis of the past decade.

On behalf of Listerhill Credit Union's more than 90,000 members, thank you for allowing me to comment on this proposal.

Sincerely,

Clay Morgan
Chief of Staff Operations

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Credit Union National Association

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August 31, 2017

Gerard Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Re: Comments on Stabilization Fund Closure

Dear Mr. Poliquin:

The Credit Union National Association (CUNA) appreciates the opportunity to submit comments concerning the National Credit Union Administration's (NCUA) plan to close the Temporary Corporate Credit Union Stabilization Fund. CUNA represents America's credit unions and their 110 million members.

CUNA fully supports NCUA closing the Temporary Corporate Credit Union Stabilization Fund (TCCUSF or Stabilization Fund) as soon as possible. Furthermore, CUNA member credit unions request the NCUA to return money from the funds as soon as possible so they can put the funds to work for their members. Closing the TCCUSF in 2017 with a distribution in 2018 to credit unions is the most efficient and only legal way to transfer credit union funds back to credit unions.

CUNA thanks the NCUA Board for listening to and working with credit unions on a plan to close the TCCUSF, and for publishing this proposal for public comment. Over the past year, CUNA has had many productive discussions with the NCUA Board and staff on the importance of returning TCCUSF funds to credit unions as soon as possible and methods the agency could use to close the Fund. Although we believe the NCUA's plan to set the normal operating level is too high, and we have not always agreed with how the agency handled the corporate credit union crisis and assessed credit unions, we commend the NCUA for successful management of the TCCUSF along with a strategy to bolster recoveries through litigation with financial institutions that sold toxic assets to corporate credit unions. The TCCUSF is one of the tools that the NCUA Board and staff used expertly to shepherd federally-insured credit unions through the great recession, and its closure demonstrates the strength of credit unions and the credit unions system.

CUNA represents, by far, the most federal and state-chartered credit unions. We have engaged our members and they have strongly encouraged us to work with the NCUA to ensure that credit unions receive a TCCUSF rebate in 2018. Although CUNA members disagree with the proposed normal operating level (NOL), we believe we can continue to work with the NCUA Board over the next several years to return the NOL to its historical 1.3% while ensuring credit unions receive equitable insurance distributions for past corporate assessments.

Legal Analysis

The notice references "industry opinions that the [FCU] Act may permit a distribution to insured credit unions directly from the Stabilization Fund." CUNA has extensively analyzed the FCU Act provisions authorizing NCUA to use Stabilization Fund assets[1] and does not share this opinion.

We agree with the NCUA Board that the FCU Act gives the agency the authority to close the Stabilization Fund and requires that the Stabilization Fund's assets be distributed[2] to the Share Insurance Fund. Any other analysis of these provisions would require the NCUA to ignore the law and open the agency up to litigation, which could needlessly delay refunds to credit unions and cost the agency, credit unions and their members money.

Based on CUNA's review of the FCU Act and NCUA's analyses of the FCU Act, we agree that closing the Stabilization Fund and distributing the funds to the Share Insurance Fund as required by the FCU Act is the proper way to close the Stabilization Fund and distribute money to credit unions.

Should the NCUA close the Stabilization Fund in 2017, close it at some future date, or wait until it is currently scheduled to close in 2021?

CUNA urges NCUA to close the Stabilization Fund in 2017 by merging it into the Share Insurance Fund so that in early 2018, credit unions can receive a return of excess equity above the NOL. The Stabilization Fund was originally established to expire in 2016, but in 2010, the date was extended to 2021 to allow credit unions more time over which to spread the costs of the corporate resolution. Since the total cost of resolving the conserved corporates is now known to be lower than anticipated in 2010, and substantially less than the amounts credit unions have paid toward the resolution, an earlier closing of the Fund is appropriate.

Simply put, the reason for the Stabilization Fund was to enable credit unions to pay for the cost of corporate resolution in manageable annual installments rather than all at once. Since those costs have all been fully covered, and then some, there is no reason for the Stabilization Fund to continue.

The only reason to delay closing the Stabilization Fund would be to insulate the balance sheet of the Share Insurance Fund from the risk of volatility from what is now the balance sheet of the Stabilization Fund, which volatility derives from fluctuations in legacy asset values as they flow through the asset management estates (henceforward "legacy asset volatility"). This risk is sufficiently contained because:

- The legacy assets are now more seasoned than they were in 2010;
- By Blackrock's and NCUA's analysis, the impact of a moderate recession on the post-merger Share Insurance Fund's equity ratio would be only 4 basis point of current insured shares; and
- With further insured share growth and amortization of the legacy assets, the exposure as a proportion of total insured shares will decline over time.

CUNA therefore recommends that NCUA merge the two funds in 2017, increase the normal operating level by 4 basis points to insulate the Share Insurance Fund from legacy asset volatility, and pay all excess equity in the Share Insurance Fund to insured credit unions as soon as possible in 2018. Further, the NCUA should explicitly state the increase in the NOL is temporary lasting only so long as the legacy assets remain on the balance of the Share Insurance Fund, and will be phased down as the risk exposure from those assets decline and as total insured shares increase.

Should the NCUA set the NOL based on the Share Insurance Fund's ability to withstand a moderate recession? Or, should the Share Insurance Fund be able to withstand a severe recession? And, should the NOL be set based on preventing the stressed equity ratio from falling below 1.2% or some other level.

CUNA recommends the NCUA set the NOL at a level sufficient to withstand a moderate recession and remain at or above 1.2% of insured shares over a **two-year** forecast horizon. This is a continuation of the successful NOL policy established by the Board in 2007.

CUNA believes that the Share Insurance Fund should be, and indeed is, able to withstand either a moderate or a severe recession. It has performed well during the two moderate recessions and one severe recession since its capitalization in its current form. Following the moderate recession of 1990-1991, the equity ratio ended the years 1991 and 1992 at 1.23% and 1.26% respectively with a single 8.3 basis points premium spread over those two years. After the moderate recession of 2001, the Fund ended the year with a 1.25% equity ratio without **any** premium. During and after the severe recession of 2007 to 2009, the Fund's lowest year-end equity ratio was 1.23%, with premiums of 10 basis points in 2009 and 12.3 basis points in 2010.

CUNA strongly believes that establishing the NOL at a level that would keep the stressed equity level above 1.2% for a five-year period with no premium is excessive. Such a policy would retain more equity than necessary on the balance sheet of the NCUSIF instead of on credit union balance sheets where they could better use it. Instead, CUNA recommends the NOL be set based on being adequate to maintain the stressed equity ratio above 1.2% over a two-year period with no premium. For a five-year forecast horizon, an NOL policy should envision the possibility of modest premiums (up to 5 basis points per year) as a reasonable approach to maintain the equity ratio above 1.2% if indeed a recession occurs.

The crucial issue is the level the equity ratio should be to preclude the necessity of a **significant** premium during a time of economic stress for credit unions. The complete avoidance of future modest premiums with an elevated NOL is simply not necessary and arbitrarily leaves one of the main tools of equity ratio management—premiums—in the toolbox.

For almost all its history, the NOL has been set at 1.3%, which also is the level above which Congress has stipulated that a premium cannot be charged. This strongly suggests that Congress believed a normal operating level above 1.3% was unlikely to be necessary. Had Congress anticipated that an NOL above 1.3% might be likely, it would have granted the NCUA the power to charge a premium at equity ratios above 1.3%.

The Board established its current policy for setting the NOL in December 2007.[1] The policy was designed to manage the Share Insurance Fund's equity ratio in a countercyclical way, rising enough in good times that premiums would not be required at the troughs of recessions. Under that policy, the NCUA was to conduct an annual assessment of the future course of the equity ratio for two years of stressed conditions. Since the adoption of that policy, the NOL has been set at 1.3% **every** year.

The NCUA is now proposing to modify that policy by extending the forecast horizon from two to five years. In the current context, that would require raising the NOL to 1.39%. CUNA strongly believes this is unnecessarily high and would be a sharp departure from NCUA's past successful management of the equity ratio. The proposal describes three components of the 9 basis points increase from 1.3% to 1.39% under this proposed new policy:

- 4 basis points to account for legacy asset volatility
- 2 basis points for the expected decline in the Share Insurance Fund ratio over the next two years due to normal operating conditions (relatively strong insured share growth combined with low yields on the Fund's investments)
- 3 basis points to keep the equity ratio from falling below 1.2% over the coming five years assuming a moderate recession

The Board's proposal conflates two unrelated factors. The first is the merger of the Stabilization and Share Insurance Funds. That merger will temporarily modify the Share Insurance Fund's balance sheet, incorporating the legacy assets. CUNA believes it is only appropriate to temporarily adjust the NOL, initially by 4 basis points, to account for the additional risks this implies. However, this additional cushion should be phased out over the coming four years as the legacy asset exposure diminishes. As noted earlier, in its communication with insured credit unions, we believe NCUA should clearly state the temporary nature of this upward adjustment to 1.34%.

The second and unrelated factor is the outlook for the primary drivers of the Share Insurance Fund ratio, absent the merger, over a five-year horizon and assuming a moderate recession. This generates the additional proposed 5 basis points increase in the NOL above 1.34%. This second factor is in no way tied to the Fund merger, and is an unwarranted modification to existing policy. The proposal suggests that using a five-year horizon to evaluate the stressed equity ratio is necessary because it mimics the remaining life of the NCUA Guaranteed Note (NGN) program and would "cover the cycle of an economic downturn." There is no relation between the remaining life of the NGN program and the primary drivers that determine the stressed equity ratio, and the durations of economic expansions are quite random.

CUNA strongly urges the NCUA not to extend the forecast horizon for determining the NOL from two years (current policy) to five (proposed), thereby increasing the NOL above 1.34%. There are several reasons supporting this recommendation:

- The proposal would require credit unions to prefund distant future potential expenses based on modeling assumptions going out for five years. This would create a significant

[1] See NCUA Board Action Memorandum, December 3, 2007.

mismatch between the time when the expenses might occur, or even be known (up to five years from now), and the payment in early 2018 of those expenses by credit unions through reduced NCUSIF refunds.

- Conservative modeling practices are likely to overstate future pressures on the Fund's equity ratio in the same way that conservative modeling dramatically overestimated the costs of the stabilization program, leading to the current surplus in the Fund. Establishing the Stabilization Fund required long-term estimates. Managing the share insurance equity ratio does not. Rather than requiring credit unions to pay today (in the form of reduced Fund distributions) for future expenses that are quite likely not to occur, it would be better policy to return the maximum amount to credit unions early in 2018, and be prepared to charge modest premiums if necessary in the out years.
- The rate of return that credit unions could earn on the funds over the coming several years is in most cases greater than what NCUSIF can earn on Treasury securities. It is more efficient for credit unions to hold and use these funds until they might be needed.
- CUNA will argue in its separate comment letter on the equity distribution proposal that refunds resulting from the merger be allocated based on the amount of assessments paid by each credit union, and not on insured shares at the time of the distribution. Increasing the NOL to avoid future premiums implies using what would otherwise be assessment refunds to prepay those premiums, which would have been based on contemporaneous insured shares. This would frustrate the goal of distributing the surplus on the more equitable basis of assessment payments. If it turns out that premiums are indeed necessary a few years from now, the burden of that expense should be based on insured shares at the time of the need, not on the distribution of insured shares as long as five to ten years ago. The proposed extra 5 basis points is explicitly not to cover legacy asset risks (stabilization expenses), but to cover the standard primary drivers of the Share Insurance Fund five years into the future. Those risks should be covered in the standard way, based on contemporary insured shares.
- Holding a substantial amount of extra equity in the Share Insurance Fund by setting the NOL too high is akin to a credit union maintaining a higher than necessary loan loss allowance account today in preparation for the implementation of the Current Expected Credit Loss model (CECL) several years in the future, a practice that accounting professionals and examiners frown upon.

CUNA recommends an explicitly-noted <u>temporary</u> 4 basis points increase in the NOL to account for the exposure to legacy asset volatility. Based on projections provided by the NCUA, the following table shows what the Fund ratio would be at the end of 2019 under NCUA's proposal and CUNA's recommendation using three of the scenarios modeled by the Agency.[2]

	NCUA Proposal	CUNA Recommendation
Initial Equity Ratio, 12/17	1.39%	1.34%
Equity Ratios as of 12/19		

[2] See NCUA Board presentation, Closing the Stabilization Fund and Setting the Share Insurance Fund Normal Operating Level, July 20, 2017. Estimated from information in Table 8 of the proposal and Slide 3, and including a 4 basis points loss for legacy asset volatility under the adverse case. Cross effects between the legacy asset volatility and the primary drivers could alter these results slightly.

Base Plus	1.37%	1.32%
Base	1.35%	1.30%
Adverse	1.27%	1.22%

NCUA's proposal would preclude a premium for all the cases over the coming two years. Under CUNA's recommendation, no premium would be required in any of the cases as the equity ratio would remain above 1.2%. Under the adverse scenario, the Fund ratio would fall to slightly above 1.2%, and the NCUA could then determine if a modest 3 basis points premium would be appropriate to restore the Fund to 1.25% depending on the updated outlook at that time.

Simply put, if the NOL is to be set so that even a slight premium could not be contemplated over a five-year forecast horizon that includes a normal recession, it is unlikely the NOL would ever be as low as 1.3%. The fact that the Fund has operated successfully over the past three decades without that high a requirement suggests this is simply not necessary. In other words, adoption of the proposed policy would appear to lead to the annual setting of the NOL at around 1.35% indefinitely.

One major factor is different today from what was typical over the past three decades: the economy has experienced a sustained period of very low interest rates. As a result, the yield on the NCUSIF portfolio is as low as it has ever been, and only $4.5 billion of the Fund's $13 billion investment portfolio will reprice over the next two years. Therefore, even if interest rates continue to rise, the overall yield on NCUSIF's portfolio of Treasury securities will improve only slowly. However, this does not mean that credit unions should have to prepay for the coming few years of lower NCUSIF earnings by foregoing refunds from the merger of the two Funds. Instead, if indeed the Fund ratio continues to face downward pressure for several years because of low interest rates, insured credit unions should cover future costs of the Fund with contemporaneous small annual premiums rather than paying a substantial amount upfront in the form of a reduced distribution of past stabilization expenses.

In summary, the merger of the two Funds in 2017 will add between 20 and 22 basis points to what would otherwise be the Insurance Fund's equity ratio of 1.25% as of the end of the year.[3] Under NCUA's proposal, these 20 to 22 basis points would be used as follows:

- 5 basis points to bring the year-end ratio to 1.3%. This essentially replaces what might otherwise have been a 5 basis points premium this year, as signaled by the Board last November
- 4 basis points for legacy asset volatility5 basis points in total to cover likely Fund operations over the coming two years (2 basis points) and to extend the forecast horizon for three years (3 basis points)
- the remaining 6 to 8 basis points to be distributed to credit unions in 2018

[3] *Id.* at slide 43.

CUNA urges the Board instead to distribute 11 to 13 basis points to credit unions next year by only raising the NOL to 1.34% to account for legacy asset volatility. Under this recommendation, absent an economic downturn over the next five years, the Fund ratio would likely remain at or above 1.3% until the NOL is reduced as the legacy asset exposure declines. In the event of a typical recession sometime in the next five years, the Fund ratio would remain above 1.2%, albeit with the possibility of a few modest premiums. It is far better to return the excess funds to credit unions today and charge small premiums in the future only if necessary than to retain that surplus in the NCUSIF simply to avoid the possibility of uncertain premiums in the future.

The following table provides comparison of how the 20 to 22 basis points surplus from the Stabilization Fund would be "used" under NCUA's proposal and CUNA's recommendation:

	NCUA Proposal	CUNA Recommendation
Raise the equity ratio to 1.3%	5 basis points	5 basis points
Increase NOL as cushion for legacy asset volatility	4 basis points	4 basis points
Increase NOL as cushion for future NCUSIF operations	5 basis points	0 basis points
Distribution to credit unions in 2018	6 basis points to 8 basis points	11 basis points to 13 basis points
TOTAL	20 to 22 basis points	20 to 22 basis points

Conclusion

We commend the NCUA Board for putting this proposal out for comment despite the fact that the statutory language governing the termination of the Stabilization Fund does not require the Board to do so. Thank you very much for taking the time to listen to credit unions' views.

While we understand some credit union commenters might want NCUA to keep the Stabilization Fund open until maturity, we see no compelling reason to do so. Closing the Stabilization Fund and returning the funds to credit unions will allow them to use these resources to benefit credit union members immediately. We urge NCUA to close the Fund without delay, merge it with the NCUSIF and make an initial distribution to credit unions in 2018. We also support NCUA raising the share equity ratio temporarily by only 4 basis points above 1.3% but only if the agency provides complete transparency on the plan to return the NOL to its historical 1.3%.

Again, we appreciate the opportunity to comment on this proposal. On behalf of America's credit unions and their 110 million members, thank you for your consideration of our views. Please contact Lance Noggle at 703.508.6705 or me if you have any questions.

Sincerely,

Ryan Donovan
Chief Advocacy Officer